No. 85-1877

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IN THE

Supreme Court of the United States

October Term, 1986

AZL RESOURCES, INC.,

Petitioner,

v.

MARGARET HALL FOUNDATION, INC., *et al.*,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the First Circuit

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PETITIONER'S SUPPLEMENTAL BRIEF IN RESPONSE TO BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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The Solicitor General's Brief acknowledges that the issue presented for certiorari—whether Section 20(a) precludes common law "vicarious" liability under the Securities Exchange Act—"is a significant one, and one on which the circuits are divided" (Br. for U.S. 6). Indeed, the Solicitor General previously urged the Court to decide this question (*Id.* 7).[1] However, based on the erroneous belief

1. The question is particularly pertinent today in light of the number of lawsuits that have recently been filed involving the "insider trading" scandals, many of which raise the issue of a brokerage firm's "vicarious" liability for the misdeeds of its officers and employees.

that there is still a colorable claim of "primary" liability in this case, the Amicus Brief, signed by five attorneys of the Securities and Exchange Commission and the Solicitor General, advises against granting certiorari. But there is no colorable claim of "primary" liability in this case, as we again show below. And even if there were, it should not result in the denial of certiorari, for the issue presented in the Petition is still an issue in the case, and an important and unresolved one, as everyone acknowledges.

The lower court decisions plainly demonstrate that respondents' theory of "vicarious" liability is the only theory of liability remaining in this case; that the district court eliminated any other theory of liability; that the theory of liability remaining in this case is based on a claim of apparent authority; and that such claim is entirely inconsistent with any liability notion other than one of "vicarious" liability, for one cannot be "primarily" liable for an act which he did not authorize.

Respondents' "primary" liability claim against petitioner AZL Resources, Inc. ("AZL") was twice rejected by the district court. Only one theory of liability against AZL survived AZL's motions to dismiss, and that is a theory of "secondary" or "vicarious" liability based on common law concepts of "apparent authority" (Pet. App. 30a). This is also the only theory of liability that was considered by the court of appeals, pursuant to the district court's certification under 28 U.S.C. Sec. 1292(b) (Pet. App. 39a).

In response to AZL's first motion to dismiss, the district court rejected respondents' self-described "primary" liability theory (Br. for U.S. 3) because the very facts alleged

by respondents in their complaint "negate[d] any inference that the actions of Strong [AZL's chairman] were performed for the benefit of AZL" (Pet. App. 23a). Respondents then sought to amend their complaint to assert that AZL *could have* benefited from Strong's activities (a "primary" liability theory) and, also, that Strong acted with "at least apparent authority" in conducting his fraudulent scheme (a "secondary" liability theory) (Pet. App. 30a). The district court again dismissed respondents' "primary" liability theory, finding respondents' theory of benefit to AZL implausible (Pet. App. 30a). But it granted respondents leave to amend their complaint to assert a "secondary" liability theory against AZL, based on Strong's "apparent authority" (Pet. App. 31a).

AZL thereupon moved for reconsideration. The district court denied AZL's motion for reconsideration, but in its opinion it specifically noted that "[t]he amendment [to the complaint] made AZL a defendant once again in this litigation" *solely* "on the basis of an allegation that AZL's chairman, Maurice Strong, acted with the apparent authority of the corporation in committing securities fraud" (Pet. App. 37a). It is in that connection, assuming it is eventually proved that Strong *did* act with apparent authority, that the district court stated that AZL's liability would be direct, that is, as a principal, and not because of *respondeat superior* (Pet. App. 38a), a distinction in theories which was the subject of extended discussion by the circuit court but which is not germane to the issue on this Petition.

At no time in any of its three opinions did the district court state or imply that respondents had alleged a legally

sufficient claim of "primary" liability against AZL.[2] Indeed, the district court specifically rejected any such notion. Thus, the district court, in granting AZL's request for certification under 28 U.S.C. Sec. 1292(b), ruled that the question of law being certified was "controlling," and that a reversal of its ruling *"will terminate the litigation as to AZL"* (Pet. App. 39a). If the district court believed that a colorable claim of "primary" liability against AZL were still present, a reversal of its ruling on the viability of respondents' "apparent authority" theory of liability *would not have terminated the litigation as to AZL.*

If the Solicitor General's reading of the district court's decisions were correct, the district court engaged in a futile gesture in certifying the question at issue to the court of appeals, and the court of appeals engaged in a futile gesture in granting AZL's petition for leave to appeal and then determining the matter without reference to respondents' contention that a colorable claim of "primary" liability against AZL was still present in this case (Br. for U.S. 5). We respectfully submit that neither court engaged in such a futile gesture. Rather, both courts decided the only issue they believed remained in the case—to wit, whether respondents' claim of "secondary" liability as to AZL was viable under the Exchange Act.

Finally, even if the Solicitor General were correct that a "primary" liability theory remains, we do not believe

2. The Solicitor General believes that the district court did so in its denial of AZL's motion for reconsideration, by referring to a certain allegedly "misleading press release" of AZL (Br. for U.S. 11). That reference, however, can only be understood in the context of the district court's consideration of the legal sufficiency of the complaint's allegations of Strong's "apparent authority" (Pet. App. 30a). The district court considered that the press release was an unauthorized press release which Strong had the "apparent authority" to issue, and that Strong's representations were manipulative and not a disclosure of "inside information."

that warrants a denial of AZL's Petition. Resolution of the unresolved issue of whether the statutory "controlling person" defense of good faith precludes application of common law liability principles in securities cases would, if favorable to AZL, eliminate the major part of the claims against AZL and would also, regardless of the outcome, erase many years of confusion and conflict in the law.

In conclusion, the "significant" question "on which the circuits are divided" *is* "squarely presented in this case," and the "resolution of the question," if in favor of AZL, will, as the district court explicitly found, "terminate the litigation as to AZL" or, if the Solicitor General is correct, terminate at the very least a significant part of it.

The Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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